Why a full deposit is better than waiting for the balance

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It's fairly common in real estate contracts to see the deposit broken down into two components, an initial deposit on signing (or within a couple of business days of signing) and then the balance deposit on the satisfaction of finance, other conditions precedent, or just simply later in the contract negotiations. The standard form contracts in Queensland contain a condition that allows for the Vendor to claim the balance deposit as a part of its damages in the event that a Buyer defaults on the contract terms.

However, a recent decision of the New South Wales Supreme Court in Kazacos v Shuangling International Development Pty Ltd [2016] NSWSC 1504 (Kazacos Case) has made clear that when entering into property contracts Vendors should consider obtaining the full deposit for the transaction or risk not being entitled to claim the balance deposit in the event of Buyer default.

The Contract was for the sale of a property valued at $17 million. The contract contained a special condition requiring payment of the deposit in two instalments, the first instalment being an initial deposit and the second instalment being payable on the date of Completion (or in the event that the Buyer failed to complete) (Balance Deposit Clause). Only the initial deposit of $850,000 was paid to the Vendor.

Various extensions were provided to the date of completion but the contract was ultimately terminated. The property was resold for $18 million and the Court determined that as a result of the resale the Vendor's position was increased by $1,719,000.00 when compared to settlement under the original contract.

The Vendor sought to enforce the Balance Deposit Clause and claimed the balance $850,000.00 from the Buyer under clause 9.1 of the Contract which provided that the Vendor could claim for the deposit (up to 10% in the event of purchaser default). The Court considered whether the Balance Deposit Clause was, in fact, a deposit. The essential nature of a deposit had been previously considered in Brien v Dwyer [1978] HCA 50 where Jacobs J stated that the essential character of a deposit was:

"An assurance to the vendor, a security to him pending completion. He can take his property off the market and not concern himself with other offers in the case the sale should go off, with the comfort that at least the deposit is there for his security."

Therefore, as the Balance Deposit was required to be paid on the completion date or on default, it could not be said to be security for the performance of the Contract.

The Court considered prior decisions indicating that interpretation of whether the balance deposit is, in fact, a penalty requires looking at the timeframe for payment of the balance deposit and whether it occurs at completion or by default. Where it is, it is more likely to be classed as a penalty and not enforceable by the Vendor.

This case reiterates that Vendors need to carefully consider whether it is necessary to have a balance deposit and to ensure that either:

1) the initial deposit received under the contract is sufficient to provide comfort in the event the Purchaser fails to complete the contract; or

2) that any balance deposit is payable early on in the contract and is not linked to any default or termination provisions of the contract to increase the likelihood of it being considered a deposit and not a penalty.

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